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96th Congress }
2d Session } COMMITTEE PRINT

1981 AGRICULTURAL OUTLOOK

Papers Presented at the Agricultural Outlook Conference Sponsored by the U.S. Department of Agriculture—Held in Washington, D.C., November 17–20, 1980

PREPARED FOR THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

UNITED STATES SENATE

JANUARY 1981

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Printed for the use of the
Committee on Agriculture, Nutrition, and Forestry

U.S. GOVERNMENT PRINTING OFFICE
69-563 O WASHINGTON : 1981

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FARM INCOME OUTLOOK

(By Marvin Duncan, Assistant Vice President and Economist, Federal Reserve Bank of Kansas City)

I am pleased to participate in the 1981 Agricultural Outlook Conference as a discussant for the paper on farm income. This is a year of retrenchment for farm income, as indicated by George Hoffman's excellent and comprehensive paper. And although the reasons for that retrenchment have been debated at some length during the year, opinions have been far from unanimous.

However, for a careful observer, this retrenchment was rather clearly signaled, as early as September 1979. It ought to have been clear to agricultural producers that the excellent summer and fall grain crop prices—food and feed grains, especially—could not continue through the 1979/80 marketing year without some assistance from the demand side, such as reduced production somewhere in the world. Nonetheless, many producers held grain for sale until after January 1, 1980. Moreover, hog and poultry inventory numbers clearly pointed to sharp increases in total meat supplies during 1980. Yet that buildup was on the increase as 1980 began.

On the input side, price increases in farm production items escalated during 1979 in response to rapid increases in energy prices and a quickening in the rate of general price inflation. Thus the stage was set, as 1980 arrived, for a farm recession. That recession resulted from a number of major farm commodities reaching the low points of their respective price cycles more or less simultaneously and from general price inflation that drove input costs sharply higher. If there was any doubt in the minds of agricultural producers that they were being disadvantaged by inflation, the experience of 1980 ought to have convinced them.

However obvious an impending farm recession should have been, the popular perception of its onset was about concurrent with the President's announcement of a partial suspension of grain sales to the U.S.S.R. That event, more than any other in early 1980, was the rallying point for farmers and their elected representatives in decrying the farm recession. In retrospect, of course, that embargo was not much more than incidental in its effect on U.S. farm income. Certainly, a few producers may have sold grain at low post-embargo prices. But, for the most part, it is likely that little grain changed hands until after prices had rebounded. In retrospect, grain prices may have been strengthened in the spring of 1980, by USDA action to offset the effects of the embargo, beyond what they would have been without an embargo.

The farm recession was short-lived, however, and by shortly after midyear, a combination of cutbacks in livestock production and the prospect of drought-reduced crop production turned farm product prices around. On the cost side, the rapid price inflation of early 1980 eased substantially during the latter half of the year.

I find little to disagree with in Hoffman's discussion of 1980 cash receipts, although I might have expected slightly higher cash receipts than the $140 billion he projects. Higher grain and livestock prices—despite declines in grain output—might be expected to bring the cash receipts in a little higher, perhaps as much as $1 billion.

On the input side, the 10–12 percent increase in costs could possibly overstate actual increases. Some 1980 inputs, such as fertilizer, were purchased in 1979, and farmers may have reduced input use more than realized during the current year. Thus, while the net income figures before inventory adjustment of $24–26 billion are nearly consistent with my expectations, I think the actual figure may be about $26 billion.

The extent to which inventory adjustment will reduce total net farm income is greater than earlier projections indicated. To achieve a negative adjustment of $1 billion or more will require sharp reductions in grain inventories during the fourth quarter of 1980. This is particularly true in view of substantial price increases for grain and cotton.

I agree with Hoffman that the income decline in 1980 is not uniformly distributed. Pork and broiler producers will have a particularly bad year. Cattlemen will not be very pleased with their margins, either. Dairy farmers will only hear about the farm recession second hand. However, the adverse effect of the summer drought on farm income has probably been overstated. Price increases for grain crops have been sufficient to offset production declines for most agricultural producers. In fact, the drought greatly benefited many grain farmers. However, for those producers who lost a third or more of their production to drought, price increases may not be offsetting.

Farm income in 1981 ought to rebound substantially from 1980 levels. In fact, I would not be surprised if net income recovered most of the decline of 1980—perhaps to the $27–30 billion range. I think the stage is almost set for volatile feed grain prices in 1981 with $4.50 per bushel or higher for corn possible for limited periods, if production problems surface. Soybean prices will be substantially stronger and a poor crop in the Southern Hemisphere could add $1 to $2 per bushel to prices. Wheat and cotton prices will be strong as well. It seems likely that livestock price increases will much more than offset production cutbacks—with any reasonable level of consumer demand.

Most input costs may increase moderately in 1981. However, livestock and feed costs for livestock producers may increase substantially, narrowing their profit margins. Additionally, petroleum-based inputs may increase in price more rapidly than now expected.

It is useful to examine farm income trends in constant dollar terms to remove money illusion. When that is done, the extent to which real net farm income has deteriorated during the past half decade, as a result of price inflation, is startling. In terms of purchasing power, net

farm income this year is lower than at any time since 1945. Moreover, if farm income recovers next year to near 1979 levels, it will still lag 1979 in constant dollars by a substantial amount. Current inflation rates are rapidly shifting the mix of farm income toward one in which unrealized capital gains from real estate make up a larger proportion of total farmer profits. And that suggests the resilience of some farm businesses to farm price fluctuation is deteriorating.

I've been interested as to why farmers appear rather sanguine about the decline in net income this year. Certainly, we heard a good deal from them earlier in the year, and correctly so. I have concluded that the answer may be found, in part, with the net cash income data. With net cash income in 1980 off by 4 percent from a year earlier, farmers may think they are better off than the net income data would suggest.

Another explanation could be that farmers have made greater shifts among inputs than we currently realize—and, as a result, USDA data underestimate farm income by overestimating production expenses.

Perhaps, the ready availability of soft credit from the Farmers Home Administration (FmHA) or the Small Business Administration is defusing the more serious credit problems. Data from the 10th Federal Reserve District indicate agricultural bankers expect almost twice the usual proportion of their farm customers to be ineligible for normal bank or Production Credit Association credit in 1981. However, due to the widespread availability of FmHA disaster loans, fewer farm customers than normal may be forced from business due to credit problems.

Finally, not all farmers face the same cost structure. Those with little debt or with land purchased at much lower than current prices may be enjoying substantial profits, while more heavily leveraged or more recent entrants may be having financial difficulty.

All this diversity emphasizes the importance of disaggregating the farm sector accounts. USDA efforts in this direction are welcome additions to available data series. But how carefully the disaggregation is done will determine the reliability of the new data. With farm structure changes occurring and with changes in input mixes, it becomes very important to disaggregate using current information, rather than baseline relationships that may no longer be valid. Thus, additional USDA resources must be allocated toward developing and maintaining disaggregated data series, if they are to prove useful and reliable.

In conclusion, during 1980, the agricultural sector experienced a sharp, but brief, recession that bottomed shortly after midyear. I expect net income to farmers in 1980 to reach the upper range of USDA projections. Conversely, in 1981, I am somewhat less optimistic about net farm income than the USDA. Finally, while new measures of farm well-being and disaggregated data series are welcome, such series place much greater demands on data integrity.